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TAGS: EFIN ECON TU
SUBJECT: TWO VIEWS ON STATE BANKS

REF: A) ANKARA 6026; B)ANKARA 5999

This cable was coordinated with Congen Istanbul.

¶1. (Sbu) Summary: In separate meetings, a World Bank expert and a state-owned bank executive provided contrasting views on state bank privatization issues. The World Bank expert is taking a fresh, somewhat skeptical look at the Bank's privatization strategy, and seemed to share some of the USG concerns. Meanwhile, a Ziraat Bank executive defended her bank's policies on consumer lending, arguing that the Bank needed to develop a profitable loan business to prepare for privatization, and that Ziraat's fast-growing consumer loan portfolio was manageable and needed to be put in context. End Summary.

World Bank Expert's Fresh Look at State Bank Privatization:
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2.(Sbu) Econoffs met October 20 with a World Bank banking sector expert based in Washington, who recently took the lead on banking sector issues in Turkey. He took a fresh and somewhat skeptical look at state bank issues, understanding USG concerns that the Programmatic Financial and Public Sector Adjustment Loan (PFPSAL3)--under which the state bank privatization process is a key area of conditionality--runs the risk of disbursing a lot of money for very little tangible result.

¶3. (Sbu) The expert said he and his IFI colleagues had held a series of "unhappy" discussions with the three state-owned banks: Vakif, Halk and Ziraat. He said that Vakif's management does not even consider the bank to be a state bank. Note: Vakif is majority-controlled by the General Directorate of Foundations, a governmental body which is among the eclectic responsibilities of State Minister Mehmet Ali Sahin, along with youth and sports and collective bargaining with public sector unions. This structure has repeatedly stalled IFI efforts to move the bank towards privatization. End Note. In general, the World Bank expert did not feel that the Turkish Treasury, as the other state banks' shareholder, was putting sufficient pressure on the management of state banks to prepare for privatization.

¶4. (Sbu) The expert believes that a 2004 World Bank-financed study by McKinsey that provided the GOT with a road map for privatization was not bad but was incomplete. He said McKinsey should have also done studies of the state banks' market positions, which might have led to alternative strategies or at least steps that would help move the banks towards privatization. For example, the expert thought there might be scope to hive off Ziraat or Halk's big-city branch networks, for which there might be potential purchasers. He added that Ziraat and Halk's rural branches are the most profitable, since private competitors are largely absent from the rural market, especially in Eastern Turkey. The expert said Bank staff are working on an aide-memoire to the GOT on banking sector issues, and are likely to partially reopen some of the privatization issues.

¶5. (Sbu) The expert also expressed sympathy to the US Treasury idea that the GOT consider making tradeable the non-tradeable government securities held by the state banks. Note: The state banks outsized holdings of government securities, which are too large to be absorbed by the market (at least for now) are widely considered to be the single biggest impediment to the banks' privatization. End Note.

¶6. (Sbu) BRSA officials and other bankers (see below) have downplayed concerns that state banks might not have the credit skills to avoid running up non-performing loans through these banks' aggressive marketing of consumer loans and credit cards. They argue that the return on risk for this asset class is better than for other loans, both because of consumer loans' profitability and because of the diversification inherent to a consumer loan portfolio. The World Bank expert, however, wondered whether Ziraat had the expertise to manage its explosive consumer loan growth properly.

¶7. (Sbu) He had a somewhat more favorable view of Halk Bank's management than of Ziraat or Vakif management. Halk's management is currently consumed with integrating Pamuk Bank, but then will begin benchmarking changes needed to prepare for an eventual IPO. Though it is too late to change the decision, the World Bank expert questioned the wisdom of having merged SDIF-intervened Pamuk into Halk, rather than simply closing down Pamuk, which was deeply insolvent. He said 25 percent of Pamuk's staff-probably including their best people-had left the bank during the long wait for its absorption into Halk.

¶8. (Sbu) More broadly, the World Bank expert worried that he had yet to uncover a natural constituency or champion for state bank privatization in Turkey, which he has found to be the key to meaningful progress in other countries. Until such a local champion can be found, he believes the emphasis should be on increasing transparency.

Ziraat Bank Executive Defends the Bank's Strategy:
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¶9. (Sbu) Econoff also met with Ayse Goltar, Deputy General Manager of Ziraat Bank. Goltar, a former Deloitte CPA, was brought in three years ago by the reformist team headed by then State Bank Board Chairman Vural Akisik. She readily admitted Ziraat was not trying to shrink, but denied the Bank was being "aggressive" in pushing consumer credit. While admitting Ziraat's consumer loan rates were lower than other banks', she claimed that Ziraat charged higher commissions than other lenders, such that the all-in cost was equivalent. She agreed that the bank was trying to increase its market share in consumer lending, but pointed out that Ziraat was starting from a minuscule base and still had a much smaller market share in consumer lending than might be expected from a bank with such an extensive branch network, and which has a much larger market share in other products and services.

¶10. (Sbu) She said that as of December 31, 2002, Ziraat had only 500 trillion TL (USD 337 million) in retail loans. This portfolio had grown to 1 Quadrillion TL (USD 676 million) at the end of 2003 and 2.5 Quadrillion ((USD 1.689 billion) as of September 30, 2004. The rate of growth was obviously very high, but Goltar pointed out it was still not a big number in relation to Ziraat's capital or total assets-respectively 6 Quadrillion TL (USD 4 billion) and 46.5 Quadrillion TL (USD 31.4 billion) as of December 31,
¶2003.

¶11. (Sbu) Nor did Goltar see a significant risk of increased non-performing loans(NPL's). She said the bank had only 15 trillion TL (USD 10 million) in NPL's as of September 30 and most of these were left over from Ziraat's assumption of the failed Emlak Bank a few years ago. She said consumer loans had a maturity of only 8 or 9 months, such that if there were credit problems arising from the rapid growth they should already be showing up. The credit risk of these loans is also mitigated by the fact that most of the loans are to existing Ziraat customers who receive payment of their salaries into accounts at Ziraat-accounts that could be garnished if the borrowers failed to pay. Goltar said management had imposed regional lending ceilings for its branches' consumer loans. As branches reached these limits, the growth of consumer lending was likely to slow. The slowdown seems to have already started: Goltar said auto loans totaled 4 Quadrillion TL in August and had only grown slightly, to 4.16 Quadrillion TL in October. Finally, she emphasized Ziraat's relatively small share of the consumer loan market. In auto loans, for example, she said Ziraat's market share was only 7 percent, up from only 3 percent a few years ago.

¶12. (Sbu) On the deposit side, Goltar confirmed that in recent months Ziraat was offering lower rates than its private competitors. As a consequence, she said Ziraat's share of total Turkish Lira deposits had fallen since March from 32 to 29 percent. In the foreign exchange deposit market, where Ziraat is a less important player, she said the bank's market share had increased slightly, from 12 to 13 percent.

¶13. (Sbu) More broadly, Goltar defended management's strategy of preparing for eventual privatization by trying to build up profitable, traditional banking business to replace reliance on government securities. Ziraat's year-end 2003 financial statement shows government securities totaling 26.7 Quadrillion TL (USD 18 billion), or 59 percent of total assets. With such a high proportion of assets in government securities, and current capital-adequacy rules assigning a zero risk weight to government securities, Goltar said Ziraat's capital-adequacy ratio as of September 30, 2004 was 50 percent. If the government securities were assigned a 20 percent risk weighting, the ratio would be 30 percent.

¶14. (Sbu) The bank continues to be quite profitable in 2004.

Goltar said net income for the first nine months reached 1 Quadrillion TL (USD 676 million), and would likely hit 1.4 Quadrillion (USD 946 million) for the full year. Goltar said the profits stem from a combination of increased loan business, more profitable deposits as the bank kept deposit rates low, and continued profitability from government securities. At the end of the year, Goltar said she expects the profits to be returned to Treasury as a dividend. Goltar agreed with the World Bank expert's comment that rural branches tended to be the most profitable from a return-on-assets or return-on-equity standpoint. Ziraat derives the bulk of its profits, however, from its urban branches, according to Goltar.

¶15. (Sbu) Comment: The World Bank expert's new look at some of the difficult state bank issues is refreshing and could lead to the IFI's demanding more tangible restructuring actions at these banks in order to better prepare them for eventual privatization. Indeed, state bank privatization issues are among the difficult items preventing conclusion of negotiations on a new Standby agreement with the IMF. Goltar's arguments, while not disspelling concerns about the GOT's slow-motion approach to state bank privatization, help put the growth of consumer loans at Ziraat into perspective.